1999 Country Reports on Economic Policy and Trade Practices
Released by the Bureau of Economic and Business Affairs
U.S. Department of State, March 2000

UNITED KINGDOM

Key Economic Indicators

(Billions of U.S. Dollars unless otherwise noted) 1/

	1997	1998	1999	2/
Income, Production and Employment				
Nominal GDP	1,318.4	1,400.6	1,422.0	
Real GDP Growth (Pct)	3.3	2.5	1.5	
GDP by Sector: 3/				
Agriculture	19.8	18.2	N/A	
Mining	33.0	23.8	N/A	
Manufacturing	274.2	275.9	N/A	
Services	821.4	902.2	N/A	
Government	72.5	75.4	N/A	
Per Capita GDP (U.S. Dollars)	22,289	23,483	23,950	
Labor Force (Millions)	28.8	28.9	29.0	
Unemployment Rate (Pct)	7.0	6.3	6.0	
Money and Prices (Annual Percentage Growth)				
Money Supply Growth 4/	6.5	5.7	6.9	
Consumer Price Inflation	2.4	3.4	1.5	
Exchange Rate (USD/BPS – Annual Average)	1.64	1.66	1.63	
Balance of Payments and Trade 5/				
Total Exports FOB	281.7	272.5	149.9	6/
Exports to U.S.	34.4	36.4	25.4	7/
Total Imports CIF	301.3	306.9	176.6	6/
Imports from U.S.	41.0	42.6	27.5	7/
Trade Balance	-19.6	-34.4	-26.7	6/
Balance with U.S.	-6.6	-6.2	-2.1	7/
Total Public Debt/GDP (Pct)	42.5	40.6	38.3	
External Public Debt/GDP (Pct)	21.4	22.0	17.4	7/
Fiscal Deficit/GDP (Pct)	-1.8	0.2	0.8	
Current Account Deficit/GDP (Pct) 8/	0.8	0.0	-1.3	
Gold and Foreign Exchange Reserves	38.4	35.3	34.2	9/

Aid from U.S.	0	0	0
Aid from All Other Sources	0	0	0

1/ Converted from British Pound Sterling (BPS) at the average exchange rate for each year.
2/ All 1999 figures are forecasts, unless otherwise indicated.
3/ "Agriculture" includes hunting, forestry and fishing. "Services" includes hotels, catering, distribution, repairs, transport, storage, communication, business, finance, education, health and social work. "Government" reflects only public administration and defense.
4/ Notes and coins in circulation in the United Kingdom plus banks' official deposits with the Banking Department.
5/ Merchandise trade, converted at average exchange rate for the applicable year.
6/ Through July 1999.
7/ Through August 1999.
8/ Current prices.
9/ Through June 1999.

Sources: The Oxford Economic Forecasting and London Business School 1999 Economic Outlook, the UK Office for National Statistics, and the Bank of England.

1. General Policy Framework

The United Kingdom (UK) has the sixth largest economy in the industrialized world, with a nominal GDP of about $1.4 trillion in 1999. The UK's 59.2 million inhabitants live in an area the size of New York and Pennsylvania. Per capita income was about $23,950 in 1999.

In May 1997, the Labour Party won an overwhelming parliamentary majority, ending 17 years of Conservative Government. Prime Minister Tony Blair inherited an economy showing signs of overheating, after recovering from the 1990-92 recession. Real GDP grew 2.6 percent in 1996 and 3.5 percent in 1997 (well above the UK's historical trend of around 2.5 percent). In 1998, tighter monetary and fiscal policy combined with a stronger pound and faltering global economy to put the brake on manufacturing exports, slowing GDP growth to 2.2 percent, and raising concerns that the economy could tip into recession in 1999. In October 1998, the Monetary Policy Committee (MPC) reacted strongly to the deteriorating domestic and international conditions by cutting interest rates. Between October 1998 and June 1999, the MPC cut the base rate seven times (from 7.5 percent to 5.0 percent).

The MPC's aggressive action averted a serious slowdown in 1999, sparking a dramatic growth in both business and consumer confidence. Indeed, the downturn was far briefer and milder than had been anticipated. With growth bottoming out ahead of predictions in the last quarter of 1998 at an annual rate of 0.7 percent, the lowest rate since 1992, the economy improved steadily throughout 1999. Real GDP was forecast to grow by at least 1.7 percent in 1999 and as much as 3.0 percent in 2000.

During 1999 there were signs of recovery even in the depressed manufacturing and export sectors, with strong advances in sales and orders. The assumption is that both have now adapted to a highly valued sterling by reducing their workforces, increasing productivity, and shaving profit margins to remain competitive. Robust household consumption and retail sales have particularly buoyed output. Rising consumer confidence has been sustained by overall job growth, which continued to advance throughout the slowdown. By August 1999, the unemployment rate had dropped to a 20-year low of 5.9 percent from a high of 10.5 percent in 1993.

A deteriorating current account remains a concern. The trade imbalance has been a result of sluggish demand in Asia and Europe, exacerbated by the high pound. With the terms of trade moving against the UK, import growth for 1999 has been strong, more than counteracting growth in exports. The services balance is still positive but has shown little change since June 1999. The current account has moved from a small surplus in 1997 to break even in 1998 to an estimated deficit equal to about 1.3 percent of GDP in 1999. With more positive prospects for demand in Asia and Europe next year, the trade and current account balances should improve somewhat.

Inflation remains under control. Underlying inflation, which had remained slightly above the MPC's 2.5 percent target rate until the third quarter of 1998, had fallen below target, to 2.1

percent, by September 1999. Fearing renewed wage and housing price inflation over the next two years with a return to robust growth, the MPC raised the base rate to 5.5 percent in November 1999. Underlying inflation averaged 2.8 percent in 1997, 2.7 percent in 1998, and was forecast at 2.3 percent in 1999.

Fiscal Policy: The Labour Government has pledged to adhere to a "Code for Fiscal Stability," balancing current government receipts and expenditures. The government's financial balance has moved from a deficit of eight percent of GDP in 1993 to a small surplus of 0.2 percent of GDP in 1998. The surplus continues to grow, forecast at 0.8 percent of GDP in 1999 and expected to reach one percent by 2002. The Blair Government has also committed to continuing to decrease the public debt, from 41 percent of GDP in 1998, to 37 percent by fiscal year 2001-02.

Tax Policy: The Labour Government promised before the 1997 election not to raise the personal income tax rate, now between 20 and 40 percent; the Value Added Tax, now 17.5 percent; or personal contributions to the UK's social security system. The basic income tax rate of 23 percent will be reduced to 22 percent in April 2000. The Labour Government also introduced a new 10 percent starting tax rate for the first 1,500 pounds of taxable income in April 1999. Labour also undertook a controversial measure to tax the windfall gains of privatized utilities. Expected to yield 5.2 billion pounds over three years, the government plans to use this tax to help finance its new Welfare-to-Work program. Corporate tax rates were cut as of April 1999 to 30 percent, 20 percent, and 10 percent respectively for corporations, small companies, and new businesses with incomes under 50,000 pounds per year. To promote enterprise, small and medium businesses may now write off 40 percent of their research and development costs for the first two years of operation. Other domestic tax revenue sources include excise taxes on alcohol, tobacco, retail motor fuels, and North Sea oil production. Some of these taxes were raised in 1999, and additional energy taxes are being discussed for environmental reasons.

Monetary Policy: The government has emphasized its commitment to a low inflation policy. In one of its first official acts, the Blair Government established an inflation target of 2.5 percent and granted the Bank of England independence to set interest rates to achieve this target. The Bank must explain to the government if inflation varies from the target by more than one percentage point, in either direction.

While the MPC's sole policy instrument is its ability to change the base rate at its monthly meetings, the Bank of England manages general monetary conditions through open market operations by buying and selling overnight funds and commercial paper. There are no explicit reserve requirements in the banking system.

2. Exchange Rate Policy

Since the UK's withdrawal from the European Union's (EU) Exchange Rate Mechanism in January 1993, the pound has floated freely. The sterling appreciated significantly between the beginning of 1996 and early-to-mid-1998, with the trade-weighted exchange rate (1990=100) rising from a low of 83.5 to a high of 107.1 in April 1998. The Asian financial crisis and relatively high real UK interest rates contributed to the flight to sterling. Given worsening domestic economic projections, the pound began to soften once the MPC began to cut the UK's relatively high short-term interest rates in October 1998. The sterling index fell to 99.6 in January 1999, but had strengthened to 104.7 by September 1999 as the UK economy began to recover. The pound is expected to continue to gain ground, against both the U.S. dollar and the Euro, well into 2000.

The Labour government favors joining the new European common currency in principle but determined that doing so when the Euro was launched on January 1, 1999 would not be in the UK's interests. It is undertaking an active program to prepare the economy for the Euro, but has muted its commitment to making a decision on joining early in the next parliament, which must be elected no later than 2002. At present, the government is concentrating on convincing voters that the UK's economic future and global leadership role depend on its membership and strong participation in the EU. The decision to adopt the Euro will be based on five economic tests, the most important of which is cyclical convergence, and will be subject to a popular referendum. In addition, the willingness of continental governments to accept fundamental structural reform of their economies is also seen as essential to the success of the new currency and the UK's willingness to participate fully in Economic and Monetary Union.

3. Structural Policies

The UK economy is characterized by free markets and open competition, which the government actively promotes within the EU and international fora. The UK's relatively low labor costs and labor market flexibility are often credited as major factors influencing the UK's success in attracting foreign investment. However, relatively low manufacturing labor productivity remains a concern.

Market forces establish prices for virtually all goods and services. The government still sets prices for prescription drugs and services in those few sectors where it is still a direct provider, such as urban transportation. In addition, government regulatory bodies monitor prices charged by telecommunications firms and set price ceilings for electric, natural gas, and water utilities. The UK's participation in the EU's Common Agricultural Policy significantly affects the prices for raw and processed food items, but prices in wholesale and retail markets are not fixed for any of these items.

The Labour Government inherited an economy that underwent significant structural reforms under the previous administration, which deregulated the financial services and transportation industries and sold the government's interests in the automotive, steel, coal mining, aircraft, and aviation sectors. Electric power, rail transport, and water supply utilities were also privatized. Subsidies were cut substantially and capital controls lifted. Employment legislation significantly increased labor market flexibility, democratized unions, and increased union accountability for the industrial acts of their members. The Labour Government modified this approach, including a new national minimum wage and union recognition rules, but kept significant parts of previous legislation intact, such as outlawing union shops and secondary boycotts.

4. Debt Management Policies

The UK has no meaningful external public debt. London is one of the foremost international financial centers of the world, and British financial institutions are major intermediaries of credit flows to the developing countries. The government is an active participant in the Paris Club and other multilateral debt negotiations.

5. Significant Barriers to U.S. Exports

Structural reforms and open market policies make it relatively easy for U.S. firms to enter UK markets. The UK does not maintain any barriers to U.S. exports other than those implemented as a result of EU policies. (See the report on the European Union for details.)

The U.S.-UK Bilateral Aviation Agreement is highly restrictive, particularly in limiting the number and access of carriers serving London Heathrow Airport and the European destinations beyond UK airports to which U.S. airlines may fly. The U.S. believes the two sides should conclude an Open Skies Agreement, but the UK Government has continued to raise objections to this approach. Nonetheless, the UK government unilaterally provided open "beyond rights" to U.S. cargo carriers at Prestwick Airport, near Glasgow, Scotland in August 1999. The two sides are continuing to explore the possibility of liberalizing cargo and passenger services on a bilateral basis.

6. Export Subsidies Policies

The government opposes export subsidies as a general principle, and UK trade-financing mechanisms do not significantly distort trade. The Export Credits Guarantee Department (ECGD), an institution similar to the Export-Import Bank of the United States, was partially privatized in 1991.

The UK's development assistance program has certain "tied aid" characteristics. In 1996, the last year for which figures are available, some 14 percent of development assistance was tied. Agricultural and humanitarian assistance are not tied. In addition, various waivers of tied aid requirements are available to UK officials administering development assistance.

7. Protection of U.S. Intellectual Property

UK intellectual property laws are strict, comprehensive, and rigorously enforced. The UK is a signatory to all relevant international conventions, including the convention establishing the World Intellectual Property Organization, the Paris Convention for the Protection of Industrial Property, the Berne Convention for the Protection of Literary and Artistic Works, the Patent Cooperation Treaty, the Geneva Phonograms Convention, and the Universal Copyright Convention.

New copyright legislation simplified the British copyright process and permitted the UK to join the most recent text of the Berne Convention. The United Kingdom's positions in international fora are very similar to those of the United States.

8. Worker Rights

a. The Right of Association: Unionization of the work force in the UK is prohibited only in the armed forces, public sector security services, and police force.

b. The Right to Organize and Bargain Collectively: Nearly nine million workers, about one-third of the work force, are organized. Employers are barred from discriminating based on union membership. New legislation passed in July 1999 determines under what conditions an employer must bargain with a trade union. Employers are no longer allowed to pay workers who do not join a union higher wages than union members performing the same work.

The 1990 Employment Act made unions responsible for members' industrial actions, including unofficial strikes, unless union officials repudiate the action in writing. Unofficial strikers can be legally dismissed, and voluntary work stoppage is considered a breach of contract. Unions do not have immunity from prosecution for secondary strikes or for actions with suspected political motivations. Actions against subsidiaries of companies engaged in bargaining disputes are banned if the subsidiary is not the employer of record. Unions encouraging such actions are subject to fines and seizure of their assets.

c. Prohibition of Forced or Compulsory Labor: Forced or compulsory labor is unknown in the UK.

d. Minimum Age for Employment of Children: Children under the age of 16 may work in an industrial enterprise only as part of an educational course. Local education authorities can limit employment of children under 16 if working will interfere with the child's education.

e. Acceptable Conditions of Work: A new national minimum wage, established in 1998, took effect in April 1999. The initial minimum was set at 3.60 pounds per hour, based on the recommendations of a tri-partite commission. Daily and weekly working hours are limited by law, according to an EU directive outlawing mandatory workweeks longer than 48 hours. Implementing regulations are still being written.

The Health and Safety at Work Act of 1974 banned hazardous working conditions. A Health and Safety Commission submits regulatory proposals, appoints investigatory committees, conducts research, and trains workers. The Health and Safety Executive enforces health and safety regulations and may initiate criminal proceedings. The system is efficient and fully involves worker representation.

f. Rights in Sectors with U.S. Investment: U.S. firms operating in the UK are obliged to obey all worker rights legislation.

Extent of U.S. Investment in Selected Industries -- U.S. Direct Investment Position Abroad on an Historical Cost Basis **--** 1998

(Millions of U.S. Dollars)

Category		Amount
Petroleum		15,603
Total Manufacturing		46,436
Food & Kindred Products	4,371	
Chemicals & Allied Products	17,345	
Primary & Fabricated Metals	1,658	
Industrial Machinery and Equipment	8,464	
Electric & Electronic Equipment	3,509	
Transportation Equipment	3,433	
Other Manufacturing	7,655	
Wholesale Trade		7,772
Banking		10,365
Finance/Insurance/Real Estate		65,846
Services		13,144
Other Industries		19,483
TOTAL ALL INDUSTRIES		178,648

Source: U.S. Department of Commerce, Bureau of Economic Analysis.